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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

June 7, 2002

Ex Parte

Marlene Dortch
Secretary
Federal Communications Commission
445 12th H Street, SW, Portals
Washington, DC 20554

RE: *Application by Verizon New Jersey for Authorization To Provide In-Region, InterLATA Services in State of New Jersey, Docket No. 02-67* - **REDACTED**

Dear Ms. Dortch:

Over the past several weeks AT&T and Worldcom have submitted a number of ex partes challenging certain aspects of Verizon's New Jersey rates. These ex partes fail to raise any new issues. Verizon has already addressed these claims, and many of them are currently pending before the New Jersey Board on reconsideration. However, in the interest of ensuring that the record is complete, this letter briefly responds to AT&T's and Worldcom's recent pricing ex partes.

Switching

a. Verizon has already demonstrated that its switching rates satisfy the benchmarking test when compared with New York rates. *Garzillo/Prosini Supp. Decl.* ¶ 30. While AT&T and Worldcom continue to quarrel with Verizon's benchmarking analysis, their claims continue to be misplaced.

First, AT&T and WorldCom argue that it is inappropriate to benchmark non-loop rates together, and that the Commission is required instead to perform an individual analysis of each non-loop element. *See* WorldCom May 16, 2002 Ex Parte at 1; AT&T April 30, 2002 Ex Parte at 2. As Verizon has previously explained, however, the Act contains no such requirement and AT&T and Worldcom are contradicted by their own previous claims. *See Verizon Supp. Reply Comments* at 19-21. As an initial matter, AT&T and Worldcom misunderstand the purpose of the Commission's benchmark analysis. The Commission is not here engaged in the setting of individual rates. That task is assigned to the state commissions by Section 252 of the Act. Rather, the issue before the Commission is whether UNEs are provided "in accordance with section 252(d)(1)," which in turn assigns state commissions the task of setting individual rates.

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As the Commission and the D.C. Circuit repeatedly have held, this does not require the Commission to perform a *de novo* review to determine whether each individual rate is deemed to be "correct." Instead, the Commission and the Court have recognized that the Commission's pricing rules are susceptible to producing a broad range of rates, and the Commission's inquiry is limited to determining whether rates generally fall within the range that the reasonable application of TELRIC principles could produce. *See, e.g., Vermont Order* ¶ 15; *Sprint v. FCC,* 274 F. 3d 549, 556 (D.C. Cir. 2001); *AT&T Corp. v. FCC,* 220 F.3d 607, 615 (D.C. Cir. 2000); *New York Order* ¶ 244. In making that determination of course, the D.C. Circuit also has made it clear that the Commission has significant discretion to structure its inquiry to take into account the exigencies of the accelerated 90-day process. And the Commission's benchmark analysis does precisely that by establishing a litmus test of sorts to determine generally whether state-set rates are within a reasonable range. Nothing more is required.

Moreover, the Commission's long-standing practice of examining non-loop elements together is especially reasonable given that it merely takes into account actual business practices in the marketplace. Because the non-loop elements at issue are only purchased in combination as part of a UNE-Platform arrangement, it is appropriate for the Commission to determine whether the price of all the non-loop rates taken together (or of an entire UNE Platform) fall within that range. *See, e.g., Massachusetts Order* ¶ 25; *Pennsylvania Order* ¶ 67 n.252; *Rhode Island Order* ¶ 40 nt.108. Indeed, WorldCom and AT&T themselves have argued in the initial New Jersey 271 proceeding that the only proper analysis of UNE rates is one that looks at rates on a combined basis. *See, e.g.* Worldcom Huffman Decl. Att. 1, filed Jan. 14, 2002 (analyzing together prices of all network elements purchased as part of a pre-assembled platform); *see also,* AT&T March 1, 2002 Exparte at 6 (endorsing Worldcom's price squeeze analysis).

Second, WorldCom continues to claim that it is improper to compare the actual state-specific minutes of use in New York and New Jersey. *See* WorldCom May 2, 2002 Ex Parte at 2-4; Worldcom May 16, 2002 Ex Parte at 1-2; *see also* AT&T April 30, 2002 Ex Parte at 2. But as Verizon has explained, switches in New Jersey experience lower average usage than switches in New York. *See Verizon Supp. Reply Comments at 22; Garzillo/Prosini Supp. Reply Decl.* ¶ 43. And because the purpose of a benchmark analysis is to compare what it costs to purchase the non-loop elements in two states, the Commission has held that relying on "state-specific [DEM minutes] rather than nationwide data to compute minutes of use for the benchmark analysis" "provide[s] a more valid comparison." *See Rhode Island 271 Order* ¶ 55, nt. 149. As WorldCom concedes, when the benchmark analysis is performed using state-specific minutes of use, the non-loop rates in New Jersey are lower (relative to costs) than the non-loop rates in New York. *See* WorldCom May 2, 2002 Ex Parte at 6 (labeled as Worldcom Attachment 2, April 19, 2002) (showing that "using VZ NJ minute assumptions" total non-loop rates in New Jersey are $5.21 compared to $5.48 in New York). In any event, Verizon also has demonstrated that the non-loop rates in New Jersey satisfy a benchmark test with the New York rates even when the comparison is made assuming that the minutes in both states are the same, using either the dial equipment minutes in New Jersey or New York and applying the Commission's own assumptions. *See Garzillo/Prosini Supp. Reply Decl.* ¶ 43.

Third, WorldCom argues that, because switching costs are computed on a per-line basis, it is improper to measure these costs against rates that are based on "a combination of per-minute and per-line" charges. At bottom, this claim is largely an attempt to repackage WorldCom's claims that the Commission should analyze switching rates separately from other non-loop elements, and should do so applying "a fixed basket of line and minute demand levels." *See* WorldCom May 16, 2002 Ex Parte at 2. As described above, however, these arguments fail both as a legal and as a factual matter. Beyond that, WorldCom's complaint lies with the rate structure adopted by the New Jersey Board, which allows Verizon to recover its switching costs through a combination of fixed and per-minute charges. As the Commission has held, however, this rate structure is entirely consistent with the Act. *See, e.g., Local Competition Order* ¶ 810 (permitting state commissions to establish switching-rate structures that rely on "either a flat-rate or per-minute usage charge for the switching matrix and for trunk ports, which constitute shared facilities."). Moreover, the Commission has recognized that, precisely because different states may have "rate structure differences . . . that recover more of the switching costs through the flat-rated port charge," rather than through usage-sensitive rates, the appropriate benchmark comparison is one that compares all non-loop rates together. *Massachusetts Order* ¶ 25. Consequently, AT&T's and Worldcom's benchmarking claims must be rejected, and Verizon's application can be approved on this basis alone.

b. Likewise AT&T and Worldcom repeat their previous arguments relating to a few of the inputs adopted by the New Jersey Board in setting the switching rates. Of course, because the rates benchmark, those claims would be beside the point even if they were correct. In any event, the claims continue to be misplaced.

As an initial matter, the long distance carriers have raised their claims directly with the New Jersey Board in connection with their petitions for reconsideration filed by AT&T and Worldcom. *See AT&T's Motion for Reconsideration and Clarification of the Board's March 6, 2002 Order,* Dkt. No. TO00060356, filed April 3, 2002 at 4 ("*AT&T PFR*"). As the Commission recently made *clear*, when the long distance carriers made essentially the same claims in another proceeding, they should be addressed in the first instance by the state commissions – not by this Commission in the context of a Section 271 application. *See e.g. Vermont Order* ¶¶ 20, 25. For example, as it did in that case, Worldcom continues to claim that Verizon inappropriately uses 251 business days to estimate annual switch usage. Worldcom May 16, 2002 at 2; *see also Worldcom's Petition for Reconsideration,* Dkt. No. TO00060356, filed April 2, 2002 at 14. At the same time, Worldcom appears to concede that the 365 day figure it proposed is unsupportable and now argues the number should be somewhere in between. *See Worldcom Comments* (New Jersey 271 I) filed February 1, 2002; *Worldcom Comments* (New Jersey 271 II), filed April 8, 2002. But, of course, what the "right" number is for use in New Jersey is a determination that can only be made by the New Jersey Board and that issue is now before the Board as a result of Worldcom's reconsideration petition.

Moreover, a brief review of the principal switching-related claims in AT&T's expartes shows that they too are without merit. AT&T argues that Verizon's switching rates result in Verizon over-recovering its switch investment costs by 149 percent. AT&T April 30, 2002 Exparte at 2. To support this point, AT&T purports to compare Verizon's total switching usage investment to the depreciation portion of Verizon's switching usage revenues. However, AT&T's analysis is fatally flawed because it understates Verizon's total switching investment.

The ****** figure that AT&T relies on for its analysis does not reflect Verizon's total switching investment. Instead, it represents only Verizon's total "material" costs for actual switching equipment as reflected by the price charged by the vendor. This figure does not, however, include the costs Verizon incurs for engineering, furnishing and installing ("EF&I") the switching equipment; the power costs Verizon incurs to operate the switching equipment; or the investment required to support vertical features. When EF&I and power factors alone are applied to total switching usage figure AT&T cites, the investment amount increases by approximately ****** percent. Each of these are legitimate costs that Verizon's switching rate is designed to recover. Because the total switching investment figure AT&T relies on does not reflect these costs, AT&T's conclusion that Verizon over-recovers its costs is simply wrong.

Additionally, AT&T's analysis uses the wrong number of minutes in calculating Verizon's recovery of switch investment costs over a 15 year period. AT&T's analysis assumes ****** minutes per year by multiplying annual minutes per line times the number of lines in the cost study times 15 years. However, this calculation results in the total number of "capacity" minutes rather than the total number of "billable" minutes. Billable minutes are the relevant type of minutes for determining the amount of switching investment that Verizon will actually recover. Because non-conversation time is included in capacity minutes but is excluded from billable minutes, AT&T calculation overstates the billable minutes of use. By so doing, AT&T also overstates Verizon's revenues. If AT&T had eliminated the non-conversation time from its calculation, the number of billable minutes would be reduced by approximately ****** billion minutes. This error alone results in an overstatement of Verizon's revenue by ****** percent. In short, AT&T's "revenue to switch investment comparison" is completely unreliable because it understates switch investment and overstates revenue.

Lastly, AT&T is incorrect when it claims Verizon did not provide AT&T with its SCIS cost models or inputs until April 19, 2002. Verizon provided AT&T with the SCIS cost model and the Verizon cost inputs on August 11, 2000 as part of the underlying New Jersey UNE proceeding. *See In the Matter of the Board's Review of Unbundled Network Elements Rates, Terms and Conditions of Bell Atlantic-New Jersey, Inc., Docket No. TO00060356,* Letter, dated August 11, 2000 from Hesser G. McBride, Jr. on Behalf of Verizon NJ to Secretary, New Jersey Board of Public Utilities. On November 20, 2001, the New Jersey Board released its own cost inputs which AT&T had access to and which Verizon used to generate its current switching rates. *See In the Matter of the Board's Review of Unbundled Network Elements Rates, Terms and Conditions of Bell Atlantic-New Jersey, Inc., Docket No. TO00060356,* Transcript of New Jersey Board's Public Agenda Meeting, November 20, 2001. Consequently, AT&T had access to both the SCIS cost model and Board-approved inputs as part of the state proceeding before Verizon even filed its 271 application. In any event, Verizon has also made the model and inputs available again in this proceeding.

Hot Cut Rate

AT&T also continues to repeat its claim that the $35 hot-cut rate in New Jersey is not TELRIC compliant. *See* AT&T April 26, 2002 Ex Parte at 2. Its primary argument is that "Verizon has offered no new cost studies" to support the $35 rate. *Id* But, as Verizon has previously explained, that is irrelevant given that the current rate is a small fraction of what both the New Jersey and New York commissions found – based on extensive cost studies that Verizon submitted in both states – to be the TELRIC cost of performing a hot cut. *See Verizon Supp. Filing* at 14-15, 17; *Verizon Supp. Reply Comments* at 8-9. As Verizon has demonstrated – and as AT&T has failed to refute – these cost studies are based on work-time estimates that the PSC deemed "credible" and the BPU found "reliable." *See Proceeding on Motion of the Commission to Examine New York Telephone Company's Rates for Unbundled Network Elements*, Recommended Decision on Module 3 Issues by Administrative Law Judge Joel A. Linsider, Case 98-C-1357, at 186, 188 (NY PSC May 16, 2001); *Review of Unbundled Network Elements Rates, Terms and Conditions of Bell Atlantic-New Jersey, Inc.*, Decision and Order, Docket No. TO00060356, at 162 (NJ BPU rel. Mar. 6, 2002).

Moreover, the $35 rate in New Jersey is substantially lower than the non-recurring hot-cut rate that the Commission recently approved in Georgia and Louisiana. The rates in Georgia and Louisiana are $94.94 and $65, respectively. *See Bell South Georgia SGAT* at Attachment A. (Sum of Cost Reference Items, A.1.1 ($42.54), A.1.3 ($16.11), F.1 ($0.55) and A.1.4 ($35.74)), *BellSouth Louisiana SGAT* at Attachment A (Sum of Cost Reference Items, A.1.1 ($36.54), N1.1 ($2.98), N.1.5.($7.92) and N.1.6 ($17.56)).

Finally, Verizon has demonstrated that its costs are more than $35 for just a few of the steps required to perform a hot cut, including those steps taken to ensure that CLECs are ready to accept a physical transfer of the loop in the central office. *See Garzillo/Prosini Supp. Decl.* ¶¶ 21-25; *Garzillo/Prosini Supp. Reply Decl.* ¶¶ 11-12, 16. This analysis --which is based on the time estimates that both the New Jersey and New York commissions have endorsed -- further confirms that the $35 rate more than complies with TELRIC. *See Garzillo/Prosini Supp. Reply Decl.* ¶¶ 11-12. AT&T's only response to this is to claim that many of the steps that Verizon actually takes in performing hot-cuts were put into place as a "short-term cure" and are no longer necessary. *See Walsh Supp. Decl.* ¶ 24. As Verizon has demonstrated, however, many of these steps were specifically requested by CLECs in the first place, and have in fact proven valuable in preventing CLECs' own errors during the hot-cut process from placing customers out of service. *See Garzillo/Prosini Supp. Decl.* ¶¶ 22-24; *Lacouture/Ruesterholz Reply Decl.* ¶ 17.

DUF Rates

AT&T claims Verizon concedes that its DUF rates recover costs of 13 employees even though those costs are already recovered through Verizon's annual cost factor for other UNEs. AT&T April 30, 2002 Exparte, Baranowski Supp. Decl. ¶12. AT&T is wrong. In its Supplemental Reply, Verizon indicated that it had *already* removed from the annual cost factors the computer costs for the DUF and the maintenance and operating costs, including labor costs. Additionally, Verizon removed the labor costs associated with the Central Billing Organization, which is involved in processing the DUF records. *Garzillo/Prosini Supp. Reply Decl.* ¶ 51. Consistent with industry accounting standards, Verizon removed these labor costs at an aggregate account level. AT&T's only point appears to be that in removing DUF-related labor costs from the annual cost factors at an aggregate level that Verizon may not have removed all of the relevant labor costs – in particular those associated with 13 employees. But as Verizon already explained in its Supplemental Reply Declaration, even if it (redundantly) removed the labor costs for 13 equivalent workers -- in addition to the labor costs that already have been removed --from the Other Support factor (an expense factor within the annual cost factor), that the Other Support factor would not materially change. *Id.*

To support its claim that Verizon's New Jersey DUF rate is inflated, AT&T also compares that rate to the rate in Pennsylvania. AT&T April 30, 2002 Exparte, Baranowski Supp. Decl. ¶14. But the Pennsylvania DUF rate on which AT&T relies was based on a 1996 cost study. Verizon has proposed a new Pennsylvania DUF rate which was developed using the same, more recent cost study that was used in New Jersey. After reviewing this newly-proposed rate, a Pennsylvania ALJ recently recommended a new DUF message recording rate that is higher than the corresponding New Jersey rate. Because the message recording element makes up the bulk of the DUF rate, adoption of the Pennsylvania ALJ's recommendation would result in an aggregate Pennsylvania DUF rate that is comparable to the aggregate DUF rate in New Jersey. In any event, as with the other pricing issues AT&T has raised, the Commission need not address AT&T's claims because AT&T has already challenged Verizon's DUF rate as part of its petition for reconsideration pending before the New Jersey Board. *AT&T PFR* at 18.

Feature Change Service Orders

Next, AT&T contends Verizon's non-recurring charge for feature change service orders is inflated. AT&T misunderstands the rate structure adopted by the New Jersey Board. The service order charge for feature changes is included in one of five general categories of service orders, and the rate was set to apply to all service orders in the category. Consequently, rather than ignoring the costs associated with feature change service orders as AT&T suggests, the New Jersey rate structure simply adopts service order charges at an aggregate level for the various categories rather than a multitude of separate charges for each individual rate element. There is nothing about the structure that demonstrates a clear error on the part of the New Jersey Board. Again, however, the Commission need not resolve AT&T's complaints regarding the rate for feature change service orders as AT&T has already raised this issue with the New Jersey Board. *AT&T PFR* at 20. And it is the New Jersey Board that should decide what the "correct" rate structure is for New Jersey.

This ex parte contains proprietary information and is subject to confidential treatment. A redacted version is also being filed. The twenty-page limit does not apply as set forth in DA 02-718. If you have any questions, please do not hesitate to call me.

Sincerely,

Clint E. Odom/ATD

cc: A. Johns
S. Pie